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Defense Estimative Brief

Defense Implications of China's Five Year Plan for 1986-1990 (U)

Key Judgments

■ For the rest of this decade China's defense expenditures will remain close to the constrained levels of the early 1980s. Military modernization will continue to be assigned a lower priority than the needs of China's overall economic development.

■ Due to budget stringency, procurement of new weapons and equipment will remain generally steady for the remainder of the decade, both in conventional and strategic programs. Although, by the 1990s, overall defense industrial capabilities will begin to show marked improvement, the budget resources necessary for significant re-equipment of China's military forces will not exist until the late 1990s.

■ Inadequate financial resources will still leave China relatively inferior to the superpowers--but will permit the development of an increased regional capability. By the end of the decade China's posture relative to nearby Soviet forces will show modest improvement. However, depending on the pace and scale of Soviet military upgrades in the Far East, China's relative position may not be much better than at present.

■ China will continue its current low-level military relationship with the United States. Security assistance programs will remain a key part of the relationship. However, the military technological cooperation now underway will expand very slowly, if at all, largely because of limited funding. China may increasingly turn to less expensive non-US sources, including Israel, for military technology.

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Discussion

1. █ **Continued Restraint in Defense Spending.** For the rest of this decade China's defense expenditures will remain close to the constrained levels of the early 1980s. While the draft proposal of China's forthcoming 7th Five Year Plan (FYP) for 1986-1990 did not specifically address military spending levels, it appears that the new plan will continue the strict curbs on military spending evident since 1980. Military modernization, in sum, will continue to be assigned a lower priority than the needs of China's overall economic development.
2. █ We estimate that China's defense budget will show little, if any, real increase over the announced 18 billion yuan (5.6 billion US dollars) levels of recent years. Any increases are likely to be adjustments to compensate partially for inflation, which has recently reached over ten percent per year. If this inflation rate persists over the remainder of the decade, China's military planners will encounter an erosion of the financial resources required even to maintain existing capabilities. Rising unit costs of more advanced weapons and equipment will compound this problem.
3. █ **Military Economy Measures.** Therefore, the continuation of present efforts to streamline and reorganize China's military forces will be encouraged in order to save money for desired weapons and equipment purchases. It is uncertain how much can be saved by this means. Certainly, the reduction of the armed forces by one million men, about 25 percent of total manpower, will produce savings in overall personnel expenditures. However, the extent of the savings thus realized may not be large. Projected increases in individual pay and allowances needed to attract and retain more highly skilled professional manpower and increases in training requirements will probably reduce significantly the amount of such savings that will be available for weapons and equipment purchases.
4. █ In addition to manpower reductions and reorganizations, the People's Liberation Army (PLA) will exercise tight controls over procurement and will resort to a variety of other methods to economize. One method will be the retirement of obsolete weapons from the active inventory to achieve further savings in operating and maintenance (O&M) costs. For example, the projected retirement of some 1,200 aging MiG-15 and F-5 (MiG-17) fighters will contribute to a ten percent reduction of China's combat aircraft inventory by 1990. Similar reductions may also occur in ground and naval inventories, although perhaps less rapidly than in the air force. As China shifts to production of more advanced weapons incorporating technological improvements, the defense industries will curtail production of outdated

military equipment. Because of the scarcity of funds, weapons and equipment upgraded with expensive new components will have to be purchased in limited quantities for the foreseeable future. The upgrading of forces with newly fielded equipment will be a gradual process, and the overall pace of change will be slow.

5. **Military Budget Prospects.** We expect that within the military budget the percentage of spending allocated for procurement of new weapons, equipment, and facilities will remain generally steady for the remainder of the decade, both in conventional and strategic programs. Not until the 1990s will the procurement spending curve be likely to show a significant upturn as the ability of China's military industries to manufacture more advanced weapons is acquired and as the actual production under security assistance programs begins to accelerate. We believe that, in the meantime, a larger share of military spending will be allocated to RDT&E with an eye to the production of more modern weapons in the 1990s, and to training.

6. **Other categories of defense spending probably will remain stable, or perhaps decline as a share of the budget.**

-- Personnel expenditures may actually decline over the near term as the size of China's armed forces is reduced.

-- Equipment O&M will show little change as a percentage of the budget until new generations of equipment incorporating more advanced, and hence more complex, components and subsystems begin to be produced and deployed in the 1990s.

-- Capital construction spending probably will also remain at a relatively constant share of the military budget.

7. **Outlook for Defense Industries.** Although the funding of China's defense ministries and their subordinate industries is separate from the defense budget itself, their resources will also be tightly constrained by overall national budget controls. As a result, China's defense industries increasingly will be forced to expand arms exports in order to earn foreign exchange for the purchase of new technology and to fund the production of new military equipment. China's defense industries also will continue to employ unused or underused capacity to produce civilian goods both for the domestic market and for export.

8. **Integration with the civilian economy should lead to improvements in China's defense industries, which have tended to lag behind their civilian counterparts in implementing reforms.** In response to national policy directions, China's defense industries will probably begin to establish contacts with foreign firms, and may even engage in limited cooperative ventures with

Western industries. This, in turn, would promote a more innovative approach to military production with attendant spin-offs in improved management, production methods, equipment, technical know-how, and quality of production.

9. [REDACTED] In our judgment, such changes will be a necessary prelude to the modernization of China's military-industrial capabilities to a level capable of producing military equipment comparable to the most modern fielded systems in Western or Soviet forces. We believe that this transformation will require at least five years, and probably longer. We expect the cumulative effects of these changes in China's defense industries will begin to become apparent by the 1990s, when overall defense industrial capabilities will begin to show marked improvement. Not until the late 1990s, however, will China be able to produce technologically advanced weapons in significant quantities.

10. [REDACTED] Effects on Security Assistance Programs. China's defense budget limitations will also force some hard decisions affecting China's nascent security assistance programs with the United States. The four main projects now in various stages of negotiation (F-8 avionics modernization, large caliber artillery ammunition upgrade, ASW torpedo coproduction, and antitank guided missile improvements) will compete for limited defense budget funding. These projects will be funded by the defense industrial ministries, partly from foreign exchange earned through exports, and by China's National Defense Science, Technology and Industries Commission (NDSTIC), which will provide supplementary funding from the defense budget on a selective basis. Funding tradeoffs and spending ceilings will remain a significant political issue within the defense establishment.

11. [REDACTED] To date, the F-8 interceptor avionics upgrade program appears to have the highest priority, and will receive funding. Because of the considerable expense of the F-8 program, which will cost China over \$500 million during the next six years, the other programs could well be reduced in scale, delayed, or cancelled altogether in order to release money for the F-8 upgrade. The State Planning Commission probably will incorporate money for the acquisition of large caliber artillery ammunition technology into the 7th Five Year Plan, which we expect will receive final approval at the National People's Congress in March 1986. The outlook for funding of the ASW torpedo and ATGM coproduction programs, however, appears more problematic, due mainly to the Chinese assessment that these programs are too expensive.

12. [REDACTED] We believe the high cost of such programs--all four projects could easily cost some \$2 billion over the next five years--could provide a test of China's commitment to defense

budget austerity. The allocation of funding in the 7th Five Year Plan for these programs would indicate an intention to begin a gradual expansion of China's defense budget in order to meet vital defense needs. On the other hand, continued delays or scaling down of these projects--or outright cancellation of some--would indicate that China intends to adhere to its current program of defense austerity, however unpalatable.

13. [REDACTED] Policy Justification for Defense Spending Curbs. In our judgment, China will continue to restrict defense expenditures under the new five year plan. We believe such a decision will reflect high level assessments that China's security is not immediately threatened by a Soviet invasion, and that the prospect of a world war that might involve China has receded. Thus, China's leaders perceive a window of opportunity that will enable them to hold the line on defense expenditures in order to concentrate national resources on promoting overall economic and technological growth and modernization. China's leaders are convinced that their country's ultimate security will depend on the success of this effort. We believe, therefore, that China will continue to accord a lower priority to defense than to overall agricultural, industrial, and scientific programs.

14. [REDACTED] Implications for the United States. We believe the continuation of China's present policies restricting defense expenditures in order to free resources for basic economic growth will restrain the pace of China's military modernization program in the short term, while improving the industrial base for long-term military growth. Although technology acquisitions will enhance China's capability to produce improved military equipment and weapons in limited numbers, the budget resources necessary for significant re-equipment of China's military forces with the most modern equipment do not exist, and will not exist until the 1990s or later.

15. [REDACTED] The expense of increasingly complex modern weapons will prevent China from fielding sufficient quantities of advanced conventional weapons to counter the threat posed by China's main military adversary, the Soviet Union. By the end of the decade China's posture relative to nearby Soviet forces will show modest improvement due mainly to better organization, training, command and control, logistics, and mobility. Gradual and selective weapons and equipment upgrades, such as improved tanks, armored personnel carriers, and self-propelled artillery, will contribute to this improvement.

16. [REDACTED] Depending, however, on the pace and scale of Soviet military improvement programs in the Far East, China's relative position may not be significantly better than at present. Nevertheless, we perceive that China's limited strategic

deterrance will continue and perhaps be modestly enhanced by the 1990s. Although China's economic base and technology levels will grow in size and sophistication, limited financial resources will still leave China relatively inferior to the superpowers--but will permit the development of an increased regional capability.

17. [REDACTED] We believe China will continue to maintain its current low-level military relationship with the United States. Security assistance programs will remain an integral part of the relationship for the foreseeable future. Funds will be allocated for selected key programs. However, in our judgment, the military technological cooperation now underway will expand very slowly, if at all, because of limited funding as well as other constraints, including Chinese political and strategic calculations and bureaucratic inertia.

18. [REDACTED] The Chinese will continue to pursue the least expensive possible options for acquiring advanced military technologies, and will increasingly stress the acquisition of foreign technical know-how through relatively low-cost licensing, consulting, and technical service agreements. Programs deemed too expensive may be cancelled outright. However, other aspects of the US-China military relationship--such as high-level visits and working-level exchanges--may receive increasing emphasis.

19. [REDACTED] The Chinese will continue to seek alternative sources of military technology where feasible in order to save money and avoid excessive dependence on any one source. In particular, China may increasingly turn to European and other Western sources, including Israel, for military technology, in part because these sources represent less expensive alternatives to available US military technology.

20. [REDACTED] We believe, however, that the Chinese will continue to prefer US military equipment and technology to upgrade their military and industrial capabilities. To the extent China's defense industries were to become more open and cooperative with their Western counterparts, there would be an expanded base for US-China cooperation in defense matters.

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